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Nos. 86-781 and 86-793

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY

and

KANSAS CITY POWER & LIGHT COMPANY,
Appellants,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Appellee.

On Appeal from the Supreme Court of Kansas

BRIEF FOR APPELLANT KANSAS GAS AND ELECTRIC COMPANY

RALPH BUSH FOSTER
JAMES S. HAINES, JR.
Kansas Gas and
Electric Company
201 N. Market Street
Wichita, KS 67201
(316) 261-6611

EDGAR M. ROACH, JR.*
THOMAS E. GRAHAM
HUNTON & WILLIAMS
One Hannover Square
Fayetteville Street Mall
Raleigh, NC 27602
(919) 899-3000

RICHARD D. GARY
LAURENCE E. SKINNER
HUNTON & WILLIAMS
707 E. Main Street
Richmond, VA 23219
(804) 788-8200

Attorneys for Kansas Gas and Electric Company

* Counsel of Record

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether by denying a current return on 78 percent of the common shareholders' investment in a new power plant currently serving Kansas customers, the Kansas Corporation Commission (KCC) set electric utility rates so low as to confiscate Kansas Gas and Electric Company's (KG&E) property in violation of the Fifth and Fourteenth Amendments to the United States Constitution?

2. Whether the KCC violated KG&E's rights to equal protection and due process when, for purposes of ratemaking, it valued KG&E's new power plant differently than any other power plant in Kansas?

PARTIES BELOW

The appellants in the Kansas Supreme Court were KG&E,* for Case No. 58,914; Kansas City Power & Light Company (KCPL), for Case No. 58,917; and, Kansas Electric Power Cooperative, Inc., for Case No. 58,918.** The appellee in all three cases was the State Corporation Commission of the State of Kansas (KCC). Mary Margaret Rogers; the Attorney General of the State of Kansas; Alliance for Liveable Electric Rates; Electric Shock Coalition; City of Wichita, and Cities of Cheney, Clearwater, Derby, Garden Plain, Goddard, Kechi, Potwin and Whitewater; and Johnson County Joint Intervenor Group also participated in the appeals.

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* KG&E has no parent and no publicly held affiliates or subsidiaries.

** The Kansas Supreme Court consolidated the appeals of KG&E, KCPL and Kansas Electric Power Cooperative, Inc., from separate rate orders issued by the KCC. KG&E and KCPL filed appeals to this Court, which consolidated those appeals.

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BRIEF FOR APPELLANT KANSAS GAS AND ELECTRIC COMPANY

OPINIONS BELOW

The opinion of the Kansas Supreme Court reprinted in Appellants' Appendix to Jurisdictional Statement (App. 1a-57a)[1] is reported at 239 Kan. 483, 720 P.2d 1063 (1986). The Order of the State Corporation Commission of Kansas (KCC) dated September 27, 1985 (App. 1c-176c) is reported at 70 P.U.R.4th 475. The KCC Orders

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[1] Pursuant to an order entered by the Court on March 23, 1987, no joint appendix will be filed in this case. All references to an appendix refer to Appellants' Appendix to Jurisdictional Statement.

Denying Rehearing, dated November 15, 1985 (App. 1d-23d), and November 27, 1985 (App. 1e-4e), are unreported.

JURISDICTION

The Kansas Supreme Court issued its opinion on June 13, 1986, and denied rehearing on July 17, 1986. KG&E filed timely Notice of Appeal in the Kansas Supreme Court on September 29, 1986. (App. 1i-2i). This Court has appellate jurisdiction under 28 U.S.C. § 1257(2). *See Nantahala Power & Light Company v. Thornburg*, 106 S.Ct. 2349 (1986).[2] Alternatively, this Court has jurisdiction under 28 U.S.C. § 1257(3).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Amendment V:

> No person shall be . . . deprived of life, liberty, or property, without due process; nor shall private property be taken for public use, without just compensation.

The United States Constitution, Amendment XIV, § 1, Clauses 3 and 4:

> [N]or shall any State deprive any person of . . . property, without due process of law; nor deny to any person . . . the equal protection of the laws.

The pertinent provisions of the Kansas Public Utilities Act, K.S.A. §§ 66-101 *et seq.*, are reprinted at App. 1j-9j.

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[2] On appeal, the Kansas Supreme Court upheld the KCC Order under a challenge that the Order violates KG&E's rights pursuant to the Fifth and Fourteenth Amendments to the United States Constitution. State ratemaking orders issued under delegated legislative authority are "state statutes" for purposes of 28 U.S.C. § 1257(2). *See, e.g., Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983); *Atchison, Topeka & S.F.R. Co. v. Pub. Util. Comm'n*, 346 U.S. 346 (1953).

STATEMENT OF THE CASE

This is an appeal from a decision of the Kansas Supreme Court that affirmed a 1985 rate order of the KCC setting electric utility rates for KG&E.[3] The KCC Order denied KG&E's common shareholders any current return on 78 percent of their prudent investment in a newly completed nuclear power plant, the Wolf Creek Generating Station (Wolf Creek).[4]

KG&E provides retail electric service to 246,000 customers in south central Kansas. During the 1960s, KG&E relied entirely on natural gas as a fuel for generating electricity. In 1967, KG&E's principal gas supplier notified KG&E that it no longer would enter into long-term gas contracts.[5] To fulfill its legal obligation to provide an

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[3] Regulated rates should allow a utility an opportunity to earn revenues sufficient to pay operating expenses and cover capital costs. *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692-93 (1923). That level of revenues is defined as:

Revenue Requirement = Operating Expenses + (Rate Base x Weighted Average Cost of Capital)

This appeal focuses on the revenue requirement—the end result of the rate order—and the rate base used by the KCC to determine that revenue requirement.

[4] The rates challenged in this appeal are those set by the KCC in its 1985 Order. The KCC issued a subsequent rate order on March 11, 1987, which was the basis for the KCC's Motion to Dismiss for Lack of Case or Controversy (filed with this Court on April 10, 1987). The subsequent rate order is not the subject of this appeal.

[5] This situation was not unique to KG&E. Many electric utilities and other industries relied heavily on natural gas during the 1960s. Because natural gas was used for many important purposes, chief among them home heating, a national concern over the long-term supply and price of natural gas developed in the 1970s. This concern led Congress in the Natural Gas Policy Act and the Power Plant and Industrial Fuel Use Act of 1978 to deregulate the price

adequate and reliable supply of electric power to Kansas customers, KG&E began an orderly transition from its reliance on gas generation to a diversified generation system that included coal and nuclear plants. As part of this transition, KG&E joined with Kansas City Power & Light Company (KCPL) and later with Kansas Electric Power Cooperative, Inc. (KEPCo) to construct and operate Wolf Creek. KG&E and KCPL each own 47 percent of Wolf Creek, and KEPCo owns the remaining 6 percent.

KG&E's decision to build a nuclear plant responded not only to the need for diversification of its fuel mix, but also to the national policy favoring nuclear power. The federal government has encouraged the use of commercial nuclear power since the enactment of the Atomic Energy Act in 1946. In the early 1960s, the Atomic Energy Commission (AEC) began a program to encourage construction of commercial nuclear power plants. In a 1962 study, the AEC concluded that nuclear power would account for one-half of the national energy supply by the year 2000. Atomic Energy Commission, *Civilian Nuclear Power . . . A Report To The President—1962.*

The Organization of Petroleum Exporting Countries oil embargo in the early 1970s made nuclear power even more attractive because nuclear power reduces the nation's reliance on foreign fuel sources. With the encouragement of the federal government, many utilities began constructing nuclear plants to meet the nation's growing energy needs and to conserve scarce and increasingly expensive supplies of oil and gas. Nuclear power continues to be an important part of the national energy plan:

> Nuclear power is a major source of U.S. electricity. In 1986, it provided 16 percent of our total generation. The United States has more than 100 operable nuclear generating units, and an additional 19 are under construction.

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of natural gas and to mandate a shift away from natural gas as a boiler fuel for electric power generation.

> Nuclear energy is a secure resource, unaffected by international oil supply or price disruptions. Since 1974, nuclear power has been responsible for one-third of the total generating capacity added to meet growing demand for electricity, and it has been pivotal in reducing the use of oil and gas for electric generation.

United States Department of Energy, *Energy Security: A Report to the President of the United States* 150 (March 1987).

When construction began on Wolf Creek in 1977, estimates placed its total cost at $1 billion. When Wolf Creek began commercial operation in 1985, its cost was $2.9 billion. Despite that increase, the plant's cost remained below the industry average for comparable plants.[6] The increase in cost resulted primarily from unforeseeable new regulatory requirements affecting the design, construction and operation of nuclear plants. Witnesses for KG&E, the KCC staff and intervenors agreed that new and revised Nuclear Regulatory Commission (NRC) regulations, promulgated after construction began at Wolf Creek, accounted for at least 50 percent of the cost increase. (R. Vol. 22, G-220 at 156; R. Vol. 70, G-268 at 10034-49; R. Vol. 56, G-254 at 6354-56). Many of the regulatory changes resulted from unexpected events that occurred in the 1970s, such as the 1979 incident at the Three Mile Island plant. The Kansas Supreme Court

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[6] In hearings before the KCC, witnesses for KG&E, the KCC staff and intervenors presented detailed comparisons of Wolf Creek's cost and schedule with those of comparable nuclear plants. (R. Vol. 78, G-276, (CLH-1&2) at 8-9, 19-29; R. Vol. 23, G-221 at 320-21; R. Vol. 98, G-296 (GIR-2) IV-3 to IV-6; R. Vol. 68, G-268 at 9766-67; R. Vol. 46, G-244 at 4888-96; R. Vol. 254, G-452; R. Vol. 70, G-268 at 9963). This testimony showed that Wolf Creek's cost is below the average cost of comparable plants and the plant's construction schedule is among the shortest in the industry. (R. Vol. 78, G-276 (CLH-1&2) at 8-9, 19-29).

recognized that regulatory changes increased the cost of Wolf Creek. (App. 7a-8a).

The potential impact of Wolf Creek construction costs on electric rates has been a political issue in Kansas for years. In 1978, the year after construction on Wolf Creek began, the Kansas legislature enacted legislation prohibiting utilities from including in their rates the financing costs of a construction project until the project is complete. K.S.A. § 66-128 (App. 2j).[7] As a result of the law, KG&E had to capitalize for future recovery the project financing costs. This added $1 billion to the final cost of Wolf Creek. One Kansas legislator has stated that this Kansas law is one of her proudest accomplishments. Wichita Eagle-Beacon, August 14, 1986, at 1D, Col. 1. A year after the legislation was passed, the KCC initiated an investigation into the cost of Wolf Creek that continued until 1985 when it was consolidated with KG&E's Wolf Creek rate case. In 1984, the Kansas legislature passed the so-called Wolf Creek amendments to the Kansas public utility law. K.S.A. § 66-128a-128k (App. 2j-9j). By emphasizing the KCC's responsibility to examine a utility's actions in constructing new generating plants and focusing on nuclear power plants, the amendments sent a clear message to the KCC that the Wolf Creek rate increase should be severely limited. The principal author of the amendments described them as a "political imperative." Vancrum, *The Wolf Creek Excess Cost—Excess Capacity Bill*, 33 U.Kan.L.Rev. 475 (1985).

In late 1984, KG&E requested an increase in rates to reflect the addition of Wolf Creek to its rate base. Without exception, the KCC had used original cost to value additions to rate base for at least the past 40 years. Accordingly, KG&E based the rate increase for Wolf

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[7] The majority of states allow utilities to recover construction financing costs during the construction period. Construction Work in Progress for Public Utilities; Inclusion of Costs in Rate Base, 48 Fed. Reg. 24323, 24346 (Col. 1) (June 1, 1983).

Creek on the plant's original cost. Using this method, KG&E projected a total rate increase of $373 million. To mitigate the rate impact on customers, KG&E proposed that the increase be phased-in over five years.[8] The proposed first-year rate increase of $144.9 million was set at the minimum level necessary to assure KG&E's financial survival. (R. Vol. B-3, 430-31).

The KCC granted a *total* rate increase of only $169 million to be phased-in over four years. (App. 152c). The KCC reduced KG&E's requested rate increase in three steps:

1) The KCC excluded from rate base approximately $125 million (or 10 percent) of KG&E's $1.295 billion share of the construction costs[9] because it found that those costs were imprudently incurred. (App. 46c, 54c-55c). KG&E does not challenge that finding by the KCC.

2) Although KG&E is using its entire share of the power from Wolf Creek to provide energy to Kan-

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[8] A phase-in imposes a rate increase gradually over a period of years rather than all at once in a single year. Under its proposed phase-in, KG&E would have accrued financing charges on the portion of Wolf Creek not reflected in current rates. These financing charges would be accounted for as current non-cash income and would be accumulated as an asset to be recognized in rates at a later time. Thus, the phase-in would have given KG&E current earnings while reducing the required cash payments from ratepayers in the short term.

[9] The portion of KG&E's Wolf Creek costs regulated by the KCC is $1.295 billion. The amounts disallowed in the KCC Order are based on KG&E's total share of Wolf Creek, which includes a portion governed by the Federal Energy Regulatory Commission (FERC). The amounts at issue in this appeal are based on the $1.295 billion regulated by the KCC and thus are slightly less than the amounts in the KCC Order.

sas customers,[10] the KCC found that 327 megawatts (MW) of KG&E's share of Wolf Creek's capacity is not currently needed. (App. 67c). Accordingly, the KCC excluded from KG&E's rate base $716 million of costs related to 327MW of Wolf Creek. The KCC purported to moderate this exclusion by allowing a partial, deferred return on certain of those costs.[11] For the deferred return, the KCC valued the 327MW at $1290/kW, instead of the original cost of the plant. (*Id.*) As a result, KG&E earns no return on $305 million and only a partial (non-common equity) deferred return on $411 million of the total $716 million. (App. 109c-110c).

3) After these deductions the KCC found that the remaining cost of Wolf Creek still was too high. (App. 72c). The KCC refused to follow its consistent practice of using original cost to value plant additions. Instead, the KCC used an "economic value" of $1290/kW, the assumed cost of a hypothetical coal plant, to value the portion of Wolf Creek found to be currently needed. (App. 108c). This valuation method denied a return on an additional $194 million of KG&E's investment in Wolf Creek. The KCC did not base this valuation on a finding that KG&E had acted imprudently in building Wolf Creek. (App. 101c, 109c).

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[10] On September 3, 1986, Wolf Creek set a U.S. performance record for first year nuclear power plant generation, producing 8.922 billion kilowatt hours of electricity. Nucleonics Week, Sept. 11, 1986 at 13.

[11] The KCC allowed a deferred return on the debt and preferred stock components of KG&E's capital but no return on common stock. This deferred return does not affect current rates or bring KG&E any current cash income. The return is a bookkeeping entry creating a paper asset that has value only because the KCC has promised to allow KG&E to recover this amount in future rates.

The KCC's valuation of Wolf Creek at $1290/kW denied KG&E any return on $499 million [12] of its $1.170 billion prudent investment in Wolf Creek.[13] The valuation method coupled with the KCC's other disallowances has an even greater effect. The KCC Order allows KG&E to earn a full current return on only $260 million [14] of its $1.170 billion prudent investment in Wolf Creek—a denial of return on 78 percent of KG&E's prudent investment.

In its application for rehearing before the KCC, KG&E alleged that the KCC Order resulted in confiscatory rates in violation of the Fifth and Fourteenth Amendments to the United States Constitution. KG&E also alleged that the manner in which the rates were set denies KG&E equal protection and due process in violation of the Fourteenth Amendment to the United States Constitution. In denying rehearing, the KCC did not address directly KG&E's constitutional claims. (App. 1d-23d).

On appeal to the Kansas Supreme Court, KG&E again alleged that the KCC Order is unconstitutional because it is confiscatory and violates KG&E's equal protection and due process rights. Over a strong dissent by the Chief Justice (App. 46a to 57a), the Kansas Supreme Court upheld the KCC Order.

SUMMARY OF ARGUMENT

A. The Rates Set By The KCC Are Confiscatory

The Fifth Amendment requires that a regulated utility be granted the opportunity to earn a reasonable return on capital prudently invested. As stated by the Court in

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[12] $305 million related to physical excess capacity plus $194 million related to economic excess capacity.

[13] $1.295 billion total KG&E share less $125 million disallowance for imprudence.

[14] $1.170 billion prudent investment less $716 million disallowance for physical excess capacity and $194 million disallowance for economic excess capacity.

Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679, 692-93 (1923), a public utility is entitled to an opportunity to earn a return equal to returns on investments of similar risk. The Court further stated that a reasonable return is a return that assures confidence in financial soundness, maintains credit and attracts capital. *Id.* at 693.

The Court held in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), that the scope of judicial review of rate orders challenged as confiscatory is limited to an examination of the end result of the rate order. The Court recognized that ratemaking involves a balancing of investor and consumer interests that is best done by an expert ratemaking body. Subsequent cases necessarily presumed that balancing would produce rates within a zone of reasonableness. *E.g.*, *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

The balancing of interests alone, however, does not satisfy the Fifth Amendment guarantee of just compensation if the end result of the balancing process falls outside the zone of reasonableness. The Fifth Amendment sets a minimum level below which rates must not fall regardless of the balance of interests. The constitutional standard for determining whether rates are confiscatory, as set forth in *Bluefield*, is whether they provide the opportunity to earn a return commensurate with returns on investments of similar risk and sufficient to assure financial soundness, maintain credit and attract capital.

KG&E's rates were set at a level that would provide an opportunity to earn less than a one-percent return on common equity although the KCC itself determined that a proper return on common equity would be 15.50 percent. The less than one-percent return actually provided by the KCC does not assure confidence in KG&E's financial integrity or allow KG&E to cover operating expenses and capital costs.

The Kansas Supreme Court's summary inquiry into the reasonableness of KG&E's rates led it to conclude that the rates were not improper because "[i]t is only the return on profit on certain costs which has been restricted by the Commission." (App. 46a). If the Kansas Court had examined this "restriction of return," as required by the constitution, it would have concluded that the restricted return on KG&E's investment in Wolf Creek produces rates that are confiscatory.

The rates set by the KCC do not allow KG&E the opportunity to earn a return commensurate with returns on investments of corresponding risk or sufficient to assure confidence in KG&E's financial integrity. Therefore, those rates fail to provide the just compensation required by the Fifth Amendment.

B. The Rate Base Valuation Adopted By The KCC Violates KG&E's Right To Equal Protection And Due Process

The KCC valued Wolf Creek differently than any other electric plant in Kansas. The Kansas ratemaking statute charges the KCC with determining the "reasonable value" of all utility property used and required to be used to serve the public in Kansas. K.S.A. § 66-128. (App. 2j). This provision of the statute has existed in substantially similar form since 1911. With the sole exception of this case, the KCC consistently has applied this provision of the statute by using net original cost as the single measure of value for all utility assets. This method of valuation has, at a minimum, allowed investors to earn a return on the actual amounts prudently spent to construct generating facilities.

In the present case, the KCC singled out Wolf Creek—the only nuclear power plant in Kansas—for treatment different than any other electric generating facility in Kansas. The KCC did not value Wolf Creek for ratemaking purposes at $2456/kW, the net original cost of

KG&E's prudent investment. Rather, the KCC valued Wolf Creek at a so-called economic value of $1290/kW (App. 108c), based upon the supposed cost of a hypothetical coal-fired plant. At the same time, however, the KCC valued KG&E's other generating facilities, including five modern coal-fired plants, at net original cost, rather than their higher economic value. The unequal treatment of Wolf Creek produced drastically lower rates for KG&E.

The unequal treatment of Wolf Creek is not rationally related to any legitimate state interest. The KCC's only justification for valuing Wolf Creek as it did was that it found Wolf Creek was too expensive. (App. 72c). The KCC therefore chose not to recognize for ratemaking purposes a significant portion of Wolf Creek's cost—a cost resulting in large part from KG&E's adherence to federal and state policies and regulations. Nothing about Wolf Creek's cost provides a basis for adopting a different valuation method for that plant. The KCC valued Wolf Creek differently because it wanted to set KG&E's rates at a politically-acceptable level. Application of a new valuation method to a single asset in KG&E's rate base is not a rational way to achieve the result desired by the KCC. The KCC's discriminatory valuation of Wolf Creek therefore violates KG&E's right to equal protection of the laws.

ARGUMENT

I. INTRODUCTION

This appeal presents an issue that is arising more frequently as utilities attempt to recover investments in new nuclear plants. Regulatory commissions around the country routinely have begun to deny utilities a normal return on funds invested in nuclear generating facilities. This practice penalizes utilities for complying with national energy policy and contradicts accepted ratemaking theory. The Department of Energy (DOE) recently warned the President about the magnitude of this problem:

> Regulators are now under intense pressures to allocate some of the enormous costs of [new generating] plants between ratepayers and investors. . . .
>
> Today's regulatory environment prompts electric utilities to focus on short-term economics . . . and to avoid new capital investment, because they no longer trust regulators to allow them to recover their costs on capital-intensive projects with long lead times.
>
> * * * *
>
> If the United States is to have an adequate supply of electricity-generating capacity in the future—based on a secure and cost-effective mix of primary energy sources—regulatory practices that discourage prudent long-term investment need to be revamped.

United States Department of Energy, *Energy Security: A Report to the President of the United States*, 130, 189, 195 (March 1987). This case reaches beyond mere redress of a single utility's grievance and permits the Court to consider the constitutional implications of a nationwide problem.

Investment in public utility property by definition is taken for the public interest, and investors have a constitutionally protected right to earn a just and reasonable return on their investment. Regulators cannot deny that constitutional protection simply because they believe a plant is too expensive. That result is particularly unfair when, as here, the high cost stems from compliance with federal and state energy and safety policies.

The importance of permitting utilities the opportunity to earn a just and reasonable return should not be minimized. The utility industry is capital-intensive. To provide continued public service, utilities must finance the construction of generation, transmission and distribution facilities. These activities require large amounts of capital which will be available from investors only if utilities are able to offer them an opportunity for a return commensurate with the risk undertaken. Justice Brandeis

recognized this in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276, 308 (1923) (Brandeis concurring):

> The prime needs of the community are that facilities be ample and that rates be as low and as stable as possible. The community can get cheap service from private companies, only through cheap capital. . . . It can get ample service through private companies only if investors may be assured of receiving continuously a fair return upon the investment.

See also Wall Street Journal, Aug. 15, 1986, at 26, col. 3. (comment by Alfred H. Kahn, former chairman of the Civil Aeronautics Board and the New York Public Service Commission.)

The current regulatory practice of denying a return on prudent investment in nuclear plants has not gone unnoticed by the investment community. The stocks of utilities with nuclear plants under construction are considered a risky investment. As noted in the DOE report, *supra*, this practice has begun to lead the utility industry to avoid the long-term investments necessary to ensure an adequate supply of electricity in the future. *See also Western Massachusetts Electric Co.*, Docket No. 85-270 (Mass. DPU 1986).

Regulators have focused on the short term "political imperative" of low rates rather than the long-term effect on investment. The *Hope Natural Gas* decision has been interpreted to require that courts accord rate orders extreme deference. The common judicial interpretation of *Hope*'s end results test allows courts to avoid meaningful review of rate orders.[15] Although courts should accord regulators discretion in setting rates, that discretion

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[15] *See, e.g., Savannah Electric & Power Co. v. Georgia Pub. Serv. Comm'n.*, 239 Ga. 156, 236 S.E.2d 87 (1977); *Nevada Power Co. v. Pub. Serv. Comm'n*, 91 Nev. 816, 544 P.2d 428 (1975).

should not allow regulators to ignore the constitutional rights of investors.

In the rare instances when state courts have attempted meaningful review of rate cases, there has been significant confusion about the constitutional standard of review. In *Georgia Power Co. v. Georgia Public Service Comm'n*, 231 Ga. 339, 201 S.E.2d 423 (1973), for example, the utility contended that the Georgia commission set rates using a rate base that was one-half billion dollars too low, resulting in rates below the constitutionally permissible zone of reasonableness. The Georgia Supreme Court agreed that the rates were outside the zone of reasonableness established by *Hope*, but it nevertheless refused to find that the rates were confiscatory. Instead, the court found that the rates fell into an " 'area of unreasonableness' which is barely above the point of confiscation." *Id.* at 427. Thus, in at least one state, there is a level for rates that is unreasonable yet not confiscatory.

The case at hand presents the Court an opportunity to reaffirm the constitutional requirement that utility investors be compensated for property dedicated to public service, regardless of a regulator's "political imperative." The desire to improve the public condition does not warrant an unconstitutional shortcut that ultimately impairs the public interest.

II. THE RATES SET FOR KG&E ARE CONFISCATORY

The KCC Order set rates for KG&E that are confiscatory. The KCC set rates that authorize KG&E to earn only $121 million in operating income which, after payment of interest and dividends to preferred shareholders, leaves net revenue, based on the evidence in the record, sufficient for a return to common shareholders of less

than one percent.[16] That is not the just compensation required by the Fifth Amendment.

A. Standard Of Review

The Fifth Amendment guarantees just compensation for private property taken for public use. This guarantee applies to the regulation of utility rates.[17] Although the early part of this century saw judicial debate over the proper scope of review of rate orders,[18] the principle of

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[16] KG&E's total $1.904 billion prudent rate base (App. 176c) represents the capital provided by common stockholders, preferred stockholders and bond holders. Common stockholders provided about 39 percent of those funds (or $736 million). From the net operating income of $120.8 million authorized by the KCC (App. 174c, line 4; App. 4d, ¶ 9), KG&E must pay $114.4 million in interest on mortgage bonds and dividends to preferred stockholders and other contractual debt. That leaves $6.4 million for common stockholders (120.8−114.4=6.4), which translates into a less than one percent return on their $736 million investment. If allowance is made for the KCC's approval of a partial (*i.e.*, no return on common equity), non-cash return (estimated to be about $14.5 million) on the portion of Wolf Creek found to be excess physical capacity, the return available to KG&E's common shareholders is still less than three percent.

[17] The power to regulate rates is premised on the dedication of property to public use. *Munn v. Illinois*, 94 U.S. 113 (1877). Therefore, when a rate order is challenged as confiscatory, the issue is whether the compensation allowed is just, not whether a taking has occurred. The Court recognized in the *Railroad Commission Cases*, 116 U.S. 307 (1886) and *Reagan v. Farmers' Loan and Trust Co.*, 154 U.S. 362 (1894), that rate regulation constitutes a taking and must not result in confiscation. Later in *Smyth v. Ames*, 169 U.S. 466, 546 (1898), the Court stated that a utility "may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it."

[18] Much of the debate centered around the method of valuing rate base. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Pub. Serv. Comm'n*, 262 U.S. 276, 289-312 (1923) (Brandeis, concurring). Beginning with *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942), the scope of judicial

just compensation has remained constant. By 1923, when the Court decided *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, the constitutional requirement of a reasonable return was settled:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. This is so well settled by numerous decisions of this court that citation of cases is scarcely necessary.

262 U.S. at 690. The return that constitutes just compensation was described in *Bluefield*: [19]

> A public utility is entitled to such rates as will permit it to earn a return . . . equal to that generally being made . . . on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Id. at 692-93.

The Court applied this standard of just compensation in its review of Federal Power Commission (FPC) rate orders governed by the Natural Gas Act (Act). *E.g.*,

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review shifted from examination of the methods of regulation (*e.g.*, the use of fair value or original cost) to an examination of the results. KG&E challenges the result of the KCC Order as confiscatory.

[19] Although the Court in *Bluefield* applied the fair value method of ratemaking adopted in *Smyth*, the Court's formulation of the test for just compensation remains distinct from that now-rejected valuation method.

Colorado Interstate Gas Co. v. Federal Power Comm'n, 324 U.S. 581 (1945); *Panhandle Eastern Pipeline Co. v. Federal Power Comm'n*, 324 U.S. 635 (1945); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). The Act required the FPC to set "just and reasonable rates." The constitutional standard was important in reviewing cases governed by the Act because "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense." *Federal Power Comm'n v. Natral Gas Pipeline Co.*, 315 U.S. 575, 585 (1942). As a result, the Act's "just and reasonable" standard was held to coincide with the applicable constitutional standard. *Id.*, at 586, cited with approval in *Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968).

In *Hope*, the Court applied the coinciding constitutional and Natural Gas Act standards for just compensation. The issue was whether rates set by the FPC fell below the "lowest reasonable rate" allowed by the Act's standard of "just and reasonable rates." The Court stated that, from the investor's point of view, just and reasonable rates provide:

> . . . enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 603.

The Court in *Hope* announced that the scope of judicial review of rate orders challenged as confiscatory is limited to an "end result" test:

> It is not theory but the impact of the rate order which counts. If the total effect of the rate order

> cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.

Hope, 320 at 602; *see also Natural Gas Pipeline*, 315 U.S. at 586. The Court's focus on the end result of the ratemaking process recognizes that ratemaking is "the product of expert judgment" that "involves a balancing of the investor and consumer interests." *Hope*, 320 U.S. at 602-603. Subsequent cases necessarily have presumed that this balancing process produces rates within a zone of reasonableness that accounts for both consumer and investor interests. If rates fall within that zone, they are not confiscatory. *See, e.g., Permian*, 390 U.S. at 770.

The Kansas Supreme Court in this case apparently believed that the balancing of consumer and investor interests itself was the end result contemplated in *Hope*, rather than the means to that end. (App. 10a-12a). Under this view, a commission that has balanced the interests of the consumer and investor would be justified in setting any rates—including rates that deny investors a just and reasonable return. (*See* App. 45a-46a). Balancing consumer and investor interests, however, is not a substitute for the constitutional protection from confiscation.

If balancing itself were the constitutional requirement, the Fifth Amendment protections would be easily circumvented by regulators bent under the weight of public pressure to set low rates. Such an approach often denies a utility the opportunity to earn a reasonable return. The DOE's recent report describes how this type of balancing has been conducted:

> In cases where utilities made investment decisions that seemed sound when approved but later appeared wrong, regulators have frequently ruled that utilities must forego recovery of a substantial portion of their sunk costs.

> When utility investment decisions have proven to be sound, on the other hand, regulators have routinely allocated most of the benefits to the utilities' customers.

Energy Security, supra, at 155.

The balancing requirement is simply a recognition that the Fifth Amendment does not mandate an exact rate in any given situation. Balancing is a ratemaking process that is supposed to result in the selection of a reasonable rate from a range of reasonable rates. Expert regulatory bodies have the ability to balance competing interests in setting rates within a zone of reasonableness. Courts do not have this expertise in ratemaking, and they will not second-guess the method used in the balancing process *as long as the end result is not confiscatory. See Hope*, 320 U.S. at 602-03.

The balancing of interests does not satisfy the Fifth Amendment guarantee of just compensation if the end result falls outside the zone of reasonableness. *Id.* The constitution provides a minimum below which the "balanced" rate must not fall:

> [T]here is a zone of reasonableness within which rates may properly fall. It is bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates.

Washington Gas Light Co. v. Baker, 188 F.2d 11, 15 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951). The lowest allowable rate must fall within the zone of reasonableness—must provide the just and reasonable return described in *Bluefield*—because "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense." *Natural Gas Pipeline*, 315 U.S. at 585.

The standard for determining whether investors' constitutional rights have been violated by a rate order is found in *Bluefield*. The standard requires an inquiry into whether the rate order permits a return to investors that

is commensurate with returns on investments having similar risk and sufficient to assure confidence in the utility's ability to maintain its credit and attract the capital necessary to meet its public service obligation. *Hope* and its progeny recognize that regulators may set rates within a zone of reasonableness, but the bottom of that zone—the lowest possible rate—is a rate that meets the requirements of *Bluefield.* A lower rate is confiscatory.

B. The Kansas Supreme Court Did Not Review Properly The KCC Order

The Kansas Supreme Court had an obligation to determine whether the rates set by the KCC allow KG&E an opportunity to earn the constitutionally-required minimum level of compensation. The court did not determine whether the KCC achieved that goal. The court's entire discussion of the reasonableness of the KCC Order is contained in two paragraphs. (App. 45a-46a). Nowhere did the court consider whether the Order provides sufficient revenue for the capital costs of the business, whether the return allowed is commensurate with returns on investments with comparable risks, and whether the return is sufficient to maintain credit and attract capital. The court therefore failed to consider whether KG&E's rates satisfy the constitutional minimum requirements that *Bluefield* and *Hope* recognize as essential for protecting investors' rights.

By ignoring KG&E's investors, the Kansas Supreme Court did not balance the interests of the concerned parties or ensure that KG&E was allowed the constitutional minimum level of rates. *See Federal Power Comm'n v. Memphis Light, Gas and Water Division,* 411 U.S. 458, 474 (1973). The court's summary inquiry led it to conclude that the rates were not improper because "[i]t is only the return or profit on certain costs which has been restricted by the Commission." (App. 46a). The "restriction of return" is exactly what must be examined

in a constitutional inquiry. If the Kansas Court had undertaken that constitutional inquiry, it would have concluded that the restricted return on KG&E's investment in Wolf Creek is unconstitutional.

C. The Rates Set By The KCC Do Not Satisfy The Constitutional Requirements

1. *The Rates Set By The KCC Do Not Allow KG&E To Earn A Return Commensurate With The Returns On Investments In Other Businesses With Corresponding Risks*

The KCC determined that a 15.50 percent return to KG&E's common shareholders on prudent investment would provide a return commensurate with returns on investments of comparable risk. As recognized by the KCC, the returns expected by investors reflect their perceptions of the company's risk. (App. 136c). Relying primarily on stock market data, the KCC found that a 15.50 percent return on KG&E's prudently-incurred investment would be reasonable. (*Id.*).

Another measure of returns commensurate with investments having similar risk is FERC's common equity benchmark rate of return for utilities subject to federal regulation. The FERC rate of return is based on information about utilities throughout the country. At the time of the KCC Order, the FERC benchmark rate of return for electric utilities was 13.96 percent. 50 Fed. Reg. 29655 (July 22, 1985).

The less than one-percent return on common equity actually allowed KG&E does not approach any of those returns.[20] Thus, despite the KCC's own findings on the

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[20] Indeed, a one-percent return is far lower than the return on investments with virtually no risk. Thirty-year U.S. Treasury notes generally are considered as very safe and therefore carry a low return. On September 27, 1985, the date of the KCC Order, these extremely low risk investments had a yield of 10.49 percent,

level of reasonable returns, it actually permitted KG&E to earn a return that is unreasonable. As a result, rates set by the KCC do not provide the just compensation required by the Fifth Amendment.

2. *The Rates Set By The KCC Are Insufficient To Assure Confidence In KG&E's Financial Integrity*

In its Order, the KCC noted that the first-year rate increase proposed by KG&E was the minimum amount that would meet KG&E's financial requirements. (App. 151c). The KCC also found that a lower, alternative rate increase proposed by the KCC staff would place KG&E under "severe financial stress." (App. 155c). The KCC went on to note that the rate increase actually adopted "will have an even more serious impact on the company's financial health." (*Id.*). Rates below those creating severe financial stress and those needed to meet minimum financial requirements obviously cannot assure confidence in KG&E's financial integrity. Those rates therefore fail to provide the just compensation required by the Fifth Amendment.

3. *The Rates Set By The KCC Do Not Provide Adequate Revenue To Cover Operating Expenses And Capital Costs*

The insufficiency of KG&E's rates is further shown by the small margin available to cover changes in KG&E's operating costs over the four-year rate phase-in period. In the fourth year of the rate phase-in, KG&E could have as little as $6 million in net operating income available to common shareholders. The KCC staff found that KG&E had about $310 million in operating expenses. (R. Vol. 32, B-66, Sched. B-1). A mere 2 percent increase in those operating expenses over the four-year period

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Wall Street Journal, September 27, 1985, at 48, col. 3, a return much higher than that granted to KG&E.

(about a 0.5 percent cost increase per year) would reduce net operating income over $6 million and would eliminate any return to common shareholders. A larger increase in operating expenses could endanger KG&E's ability to meet its current expenses or its interest and preferred stock obligations, thereby placing KG&E in default on those obligations.[21] By placing KG&E in such a precarious financial position, the KCC failed to set rates that allow KG&E to maintain its long-term credit and attract adequate investment capital.

* * * *

Cases like this demonstrate the tensions between the interests of consumers and investors and the resultant need for strong constitutional protections. Through the 1970s and into the 1980s, recurrent fossil fuel crises created a need for reliable sources of electric generation. KG&E responded with the construction of Wolf Creek. Both state and national energy policy supported that decision. During the construction of Wolf Creek, evolving regulatory requirements caused significant construction cost increases. Adding to those cost increases, the Kansas legislature passed a new law prohibiting rate recognition of financing costs of utility construction projects during the

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[21] In the face of such drastic consequences, and while prosecuting its appeal through the courts, KG&E has taken extraordinary measures to shore up its financial integrity and to maintain some access to the capital markets. The March 11, 1987, Order by the KCC, which was the subject of the KCC's Motion to Dismiss for Lack of Case or Controversy, is the most recent example of KG&E's continuing efforts to recover from the effects of the KCC's 1985 Order. The success of those efforts and fortuitous events in the general economy, however, should not prevent the Court from finding that the rates set by the KCC fail justly to compensate KG&E. Had KG&E done nothing pending appeal to prevent its financial ruin, any victory would have been hollow. That KG&E has managed to survive a disastrous rate order should not justify that rate order. If a utility acts to save itself, the possibility of a successful appeal should not be lost along with its constitutional guarantee of just compensation.

construction period. K.S.A. § 66-128 (App. 2j). That legislative action kept KG&E's short-term utility rates low,[22] but raised the ultimate cost of Wolf Creek by about $1 billion. Thus, KG&E has met its obligation to serve the public even as the public through regulation and legislation has increased the burden. Now that Wolf Creek is providing service to the public, the Constitution requires that those who use the service pay just compensation to KG&E.

III. KG&E HAS BEEN DENIED EQUAL PROTECTION OF THE LAWS

A. The KCC Valued Wolf Creek Differently Than Any Other Generating Plant In Kansas In Violation Of The Fourteenth Amendment

The KCC valued Wolf Creek differently than any other electric plant in Kansas. The KCC Order established two categories of electric generating facilities in Kansas: (1) Wolf Creek and (2) all other electric generating facilities. That classification is not rationally related to any legitimate governmental interest and violates KG&E's right to equal protection of the laws.[23]

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[22] Indeed, one reason that the Wolf Creek rate request was such a large increase over KG&E's current rates is that KG&E's rates had been kept low over the years. For example, the rate increase granted to KG&E in 1979 was described by the Kansas Court of Appeals as "most conservative if not stingy in the extreme." *Kansas Gas and Electric Co. v. Kansas Corporation Comm'n*, 5 Kan. App.2d 63, 65, 612 P.2d 184, 186 (1980).

[23] In *Hope*, this Court restricted the scope of review for cases in which utility rates are challenged as confiscatory. The Court stated that in such cases courts should focus on the end result reached and not the method used. *Hope*, 320 U.S. at 602. This limited scope of review should not apply to utilities' claims that their equal protection rights have been violated. In a case involving equal protection, the issue is whether the utility received equal treatment, not

The equal protection clause of the Fourteenth Amendment protects persons from arbitrary discrimination by the States. In the sphere of economic regulation, the equal protection clause allows reasonable legislative[24] classifications that draw distinctions between dissimilar persons and property. *See, e.g., Ferguson v. Skrupa*, 372 U.S. 726, 732 (1963); *Tigner v. Texas*, 310 U.S. 141, *reh'g denied*, 310 U.S. 659 (1940). States may not, however, invidiously discriminate against similarly situated persons or create arbitrary classifications that bear no rational relationship to a legitimate governmental interest. *New Orleans v. Dukes*, 427 U.S. 297 (1976).[25] In valuing Wolf Creek differently than all other generating plants in Kansas, the KCC has created an arbitrary classification.

The Kansas ratemaking statute charges the KCC with determining the "reasonable value" of all utility property used and required to be used to serve the public in Kansas. K.S.A. § 66-128. (App. 2j) This provision of the statute has existed in substantially similar form since 1911. Except for this case, the KCC has always applied this provision of the statute by using net original cost as the single measure of value for all utility assets in Kansas. In setting rates for KG&E, however, the KCC did not use a single measure of value for all KG&E assets. The KCC valued all KG&E assets except Wolf Creek

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whether the overall level of rates is proper. The right to equal protection cannot be denied even if rates are found not to be confiscatory.

[24] State ratemaking is a legislative act. *Cf. Atchison, Topeka & S. F. R. Co. v. Pub. Util. Comm'n*, 346 U.S. 346, 348 (1953).

[25] In recent years, this Court has refused to uphold various governmental actions because the action bore no relationship to a legitimate state interest, the state interest was not legitimate, or both. *Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432 (1985); *Hooper v. Bernalillo County Assessor*, 472 U.S. 612 (1985); *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, *reh'g denied*, 471 U.S. 1120 (1985); *Zobel v. Williams*, 457 U.S. 55 (1982).

at their net original cost. The KCC singled out Wolf Creek for valuation at a so-called economic value of $1290/kW (App. 108c), based upon the supposed cost of building a hypothetical coal-fired plant, instead of using Wolf Creek's prudent net original cost of $2456/kW. In doing so, the KCC established an arbitrary classification that is not rationally related to any legitimate governmental interest and therefore violates KG&E's right to equal protection.

B. There Is No Rational Way To Distinguish Wolf Creek From Other Kansas Electric Generating Plants For Valuation Purposes

Wolf Creek produces electricity for consumers in Kansas. The only difference between Wolf Creek and other Kansas generating plants is the fuel used to produce electricity. Wolf Creek uses uranium (currently one of the cheapest fuels available) and other plants use some form of fossil fuel (primarily coal or natural gas). The benefits that the public receives from the electricity produced at Wolf Creek are no less than the benefits received from electricity produced at any other generating plant in Kansas. Wolf Creek's use of nuclear fuel rather than fossil fuel does not provide any basis—rational or otherwise—for valuing Wolf Creek differently than other plants.[26]

The equal protection clause allows states to impose more stringent requirements on certain businesses if such regulations are necessary for the safety and protection

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[26] The KCC's actions are particularly irrational considering that Wolf Creek may provide greater benefits to KG&E's customers than other generating plants because Wolf Creek uses low cost nuclear fuel that is readily available. The lower fuel cost results in lower operating costs and a stable supply of uranium reduces the need for expensive foreign fuels. Not surprisingly, the KCC has compelled KG&E to pass on to retail customers all of the fuel savings of $44 million attributable to Wolf Creek during its first year of service.

of the public. A particularly dangerous business may justify imposition of special measures to secure life and property. The state may not arbitrarily impose on even a dangerous business, however, financial burdens not related to the special dangers that the business presents. *Gulf C.S.F. R. v. Ellis*, 165 U.S. 150, 157-59 (1897) (the hazards of a railroad do not justify a special duty to pay debts). Thus, nothing about a nuclear facility justifies treating it differently than other generating plants for ratemaking purposes.[27]

The KCC's decision to treat Wolf Creek differently for ratemaking purposes than any other power plant in Kansas is irrational. KG&E's other generating facilities, including five modern coal-fired plants, were valued at net original cost, rather than their apparently much higher economic value of $1290/kW. If the KCC believes economic value is the proper valuation method for ratemaking purposes, then KG&E's remaining facilities should be included in rate base at their economic value. Regardless of the valuation method chosen, the KCC must apply that method consistently to all of KG&E's generating plants. All electric generating plants in Kansas produce an identical product for the same purpose, and they must be valued in a consistent, nondiscriminatory fashion.

The KCC's only justification for valuing Wolf Creek differently than KG&E's other generating plants was that the plant was too expensive. (App. 72c). Wolf Creek's cost is not an attribute that justifies distinguishing it from KG&E's other generating plants for ratemaking purposes. Such an approach is akin to using a different appraisal method for real estate tax purposes for a $500,000 house than a $100,000 house just because the

[27] The government may treat a nuclear facility differently than fossil fuel facilities for purposes other than ratemaking. Classifying nuclear facilities differently than fossil facilities for safety purposes clearly is permissible. In fact, the federal government imposes more stringent safety standards on nuclear facilities.

first house is more expensive. Both properties are houses, and they must be appraised using the same method. Similarly, the KCC, although free to use any valuation method it chooses, must use a consistent method for valuing all generating plants.

C. The Valuation Method Selected For Wolf Creek Is Not Rationally Related To A Legitimate Governmental Interest

Wolf Creek is the only plant in Kansas that has been valued for ratemaking purposes at less than its *actual* prudent cost. The only reason that the KCC gave for valuing Wolf Creek differently was that valuation at full prudent cost would result in high utility rates. Although concern for high utility rates may be a legitimate state interest, valuation of Wolf Creek as if it were a coal-fired plant is not rationally related to the goal.[28] *Cf. Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 439 (1982) (asserted governmental purpose was so speculative and attenuated that the rationale amounted to no more than an exercise of strained imagination); *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (tax discrimination against foreign businesses must bear a rational relationship to a legitimate state interest). The KCC's discriminatory valuation method is not rationally related to its goal. Instead, the KCC has simply decided to penalize KG&E for building a nuclear power plant by treating Wolf Creek for ratemaking purposes less favorably than any other electric generating facility in Kansas. This the KCC may not do. The KCC must apply any valuation method even-handedly, not just to a single generating plant.

One permissible method of dealing with the KCC's concern over Wolf Creek's high cost would be for the KCC

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[28] States have a legitimate interest in the continued provision of adequate and reliable electric service to their citizens. Although states also may have an interest in electric utility rates that are not set at an exorbitant level, that interest cannot be achieved by denying the utility equal protection of the laws or setting rates at a level that is confiscatory.

to disallow costs that were imprudently incurred. The KCC, however, excluded only 10 percent of Wolf Creek as imprudent. (App. 46c-47c, 55c). Those costs are not at issue here. Wolf Creek's cost resulted from factors beyond KG&E's control: inflation, the cost of complying with new NRC health and safety regulations and the construction financing charges which under Kansas policy could not be recognized in rates until the plant was placed in commercial operation.[29] Nothing related to the prudent costs of Wolf Creek provides any basis for adopting a different valuation method for Wolf Creek than for any other generating plant in Kansas.

The KCC undoubtedly felt great political pressure to keep KG&E's rates low. Electric utilities—particularly those that operate nuclear power plants—are extremely unpopular in certain circles. The purpose of the equal protection clause is to guarantee that politically unpopular groups will not suffer discrimination through state action. *See, e.g., Lucas v. Forty-Fourth General Assembly of Colorado*, 377 U.S. 713 (1964) (personal rights are to be protected against the will of the majority); *Cleburne v. Cleburne Living Center*, 473 U.S. 432 (a city may not avoid the strictures of the equal protection clause by deferring to the wishes or objections of some faction of the body politic). The KCC adopted a previously-unused valuation method for the purpose of setting politically-acceptable rates. As a result, the KCC singled out Wolf Creek for unfair treatment.

The valuation method used by the KCC for Wolf Creek results in an arbitrary classification that is not rationally related to any legitimate governmental interest. Application of a new valuation method to a single asset in KG&E's rate base is not a rational way to achieve the

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[29] When construction financing costs are not recognized in rates until construction is complete, the utility accrues financing charges on the "bricks and mortar" cost until the plant is included in rate base. The financing charges for Wolf Creek increased the final cost by $1 billion.

result desired by the KCC, and it is a violation of KG&E's equal protection rights.

CONCLUSION

The KCC Order setting rates for KG&E violates the Fifth and Fourteenth Amendments to the United States Constitution because it does not provide KG&E just compensation. The Order also denies KG&E equal protection of the laws as required by the Fourteenth Amendment because it results in an improper classification that bears no rational relationship to a legitimate state interest. Therefore, this Court should reverse the Kansas Supreme Court's affirmance of the KCC Order and declare the rates set for KG&E to be confiscatory and in violation of KG&E's right to equal protection of the laws. This case should be remanded to the Kansas Supreme Court with instructions to apply the proper constitutional standards in reviewing the KCC Order to ensure that KG&E's rates are not set in violation of KG&E's right to equal protection and are set at a level that is not confiscatory.

Respectfully submitted,

RALPH BUSH FOSTER
JAMES S. HAINES, JR.
Kansas Gas and
Electric Company
201 N. Market Street
Wichita, KS 67201
(316) 261-6611

EDGAR M. ROACH, JR.*
THOMAS E. GRAHAM
HUNTON & WILLIAMS
One Hannover Square
Fayetteville Street Mall
Raleigh, NC 27602
(919) 899-3000

RICHARD D. GARY
LAURENCE E. SKINNER
HUNTON & WILLIAMS
707 E. Main Street
Richmond, VA 23219
(804) 788-8200

Attorneys for Kansas Gas and Electric Company

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* Counsel of Record